BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the Matter of	)	
	)	
Implementation of the	)	
Telecommunications Act of 1996	)	**CC Docket No. 96-150**
	)	
Accounting Safeguards Under the	)	
Telecommunications Act of 1996	)	

PETITION FOR RECONSIDERATION OF SBC COMMUNICATIONS INC.

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SUMMARY*

Without explanation in the NPRM or the Report and Order, the Commission amended the affiliate transaction rules to make them applicable to a LEC's performance of nonregulated activities on behalf of a nonregulated affiliate and vice versa. Prior to this amendment, Section 32.27's six references to a LEC's "regulated activity" reflected that it was not applicable to transactions with a LEC's nonregulated activities. This expansion of the affiliate transaction rules was the subject of a separate non-rulemaking proceeding, the Citizens CAM Application for Review, and was excluded from the rule changes being considered in this proceeding. The only implied references to this rule change are embedded in the Report and Order's ruling on a different issue presented in the NPRM, that is, whether to apply the revised affiliate transaction rules to all affiliates (not, all transactions) or only to those affiliates required by the 1996 Act.

Because the Commission did not permit this issue to be adequately addressed in this proceeding, the Commission has not justified this expansion of the affiliate transaction rules. In particular, the Commission has not explained why it is necessary to expand the affiliate transaction rules to apply to nonregulated activities in order to protect LECs' regulated ratepayers against cross-subsidy, which is the purpose of this regulation as restated in the 1996 Act (*e.g.*, Sections 260, 275 and 276) The Part 64 cost allocation rules remove from regulation all of the costs attributable to a nonregulated activity, such as alarm monitoring, and thus, it is not necessary to apply the affiliate transaction rules to further break down the nonregulated costs into the amount

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* The abbreviations used in this Summary are defined in the body of this Petition.

of costs (or revenue) attributable to each transaction with each affiliate. The Commission should issue a further notice on this issue in which it would reconsider the unstated reasons for this rules change.

In a conclusory fashion, the Commission determines that because its existing regulation of incidental interLATA services under Parts 36, 69 and 61 is inherently imprecise, it must classify such services as nonregulated solely for federal accounting purposes. The Commission does not explain why its existing regulations are inadequate, nor does it assess whether the magnitude of the inadequacy is sufficient to justify the makeshift application of Part 64. In any event, if the existing rules are inadequate, the Commission should fix any problems with these rules, instead of misapplying a regulatory mechanism that is not intended to separate the costs of one regulated service from all the rest. In addition, the Commission failed to address SBC's argument that each type of incidental interLATA service in the statute is either regulated or nonregulated, and if it is nonregulated, the existing Part 64 rules will fully allocate the underlying costs.

The Commission should clarify that it did not intend to expand the "chain transaction" principle beyond the original statement of that principle in the 1988 NYNEX CAM Order. For example, that principle does not apply if the prevailing price method applies to the transaction between the carrier and its affiliate.

The Commission should reconsider its interpretation of Section 61.45(d)(1)(v) of its rules as requiring an exogenous adjustment whenever costs are reallocated from regulated to nonregulated activities. It is an overbroad interpretation of Section 61.45(d)(1)(v) to construe it to require exogenous changes with every routine reassignment of costs from the regulated to the nonregulated jurisdiction, a result not intended by the price cap rules. There is a logical tie

between Section 61.45(d)(1)(v) and Section 64.901(b)(4), which relates to the the "allocation of central office equipment and outside plant investment costs between regulated and nonregulated activities." Section 61.45(d)(1)(v), like Section 64.901(b)(4), was not intended to address the routine reassignment of assets; rather, it was specifically structured to "deter manipulative underforecasting of nonregulated usage [of network assets] and to mitigate the impact on ratepayers of unintended or unavoidable underforcasts."

The Report and Order's interpretation of Section 61.45(d)(1)(v) is inconsistent with the expressed purpose of price cap regulation of severing the linkage between costs and prices. SBC and other commenters pointed out this conflict with price cap regulation, but the Report and Order fails to address it. The Report and Order also fails to respond to NYNEX's references to previous orders of the Common Carrier Bureau clearly indicating the narrow scope of Section 61.45(d)(1)(v), including a ruling in which the Bureau rejected arguments by MCI for a broad application of this exogenous cost rule. The Commission should reconsider its incorrect interpretation of Section 61.45(d)(1)(v) in light of the original purpose of Section 61.45(d)(1)(v) and the price cap rules, practical considerations, as well as arguments presented by commenters that were not addressed in the Report and Order.

In view of the six months notice of accounting rule changes required by Section 220(g), the Commission should revise the Report and Order to reflect that its accounting rule changes are effective in six months.

With respect to those separated affiliates not subject to the SEC's Form 10-K requirements, the NPRM's request for comments as to what Section 274(f) meant by "substantially equivalent to the Form 10-K" suggested that the Commission was considering some

simplification of the Section 274(f) reporting requirement based upon a reasonable interpretation of "substantially equivalent" in this context. Instead, the Report and Order requires that such "separated affiliates" file a report containing exactly "the same information as is required in the SEC's Form 10-K." For these separated affiliates that would not otherwise file a Form 10-K, the Commission should adopt a simplified report that contains a substantial part, but not all, of the Form 10-K. The Commission should eliminate any information that is not truly necessary to ensure compliance with the provisions of Section 274. A number of items listed in Exhibit A to this Petition can be omitted from the Section 274(f) report without compromising the Commission's ability to enforce Section 274.

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PETITION FOR RECONSIDERATION OF
SBC COMMUNICATIONS INC.

SBC Communications Inc. ("SBC")[1] respectfully requests that the Commission reconsider and/or clarify certain aspects of its Report and Order in the above-captioned proceeding. SBC continues to believe that, in view of price cap regulation and similar forms of state regulation, none of the accounting safeguards are necessary to prevent cross-subsidy at the expense of regulated service customers. Therefore, at a minimum, the Commission should streamline the cost allocation and affiliate transaction rules consistent with the objective of minimizing the burden of regulation and the pro-competitive, deregulatory national policy framework of the Telecommunications Act of 1996.[2] Nevertheless, at this time, SBC only seeks reconsideration of the Report and Order to the extent it adopted more onerous or detailed

[1] SBC Communications Inc. ("SBC") files these Comments by its attorneys and on behalf of its subsidiaries, including Southwestern Bell Telephone Company ("SWBT") and Southwestern Bell Mobile Systems, Inc. ("SBMS").

[2] Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56, codified at 47 U.S.C. §§151 *et seq.* ("1996 Act").

accounting safeguards than those previously in effect. For the reasons explained herein, the Commission should at least reconsider its decision to increase the burden of its accounting safeguard regulation. This is especially true in those areas where more expansive regulation does not serve the statutory purposes as efficiently or effectively as the existing, narrower regulation.

I. UNNECESSARY REGULATION OF A LEC'S PERFORMANCE OF NONREGULATED ACTIVITIES ON BEHALF OF A NONREGULATED AFFILIATE AND VICE VERSA.

Without discussing the reasoning in either the NPRM or the Report and Order, the Commission amended the affiliate transaction rules in Section 32.27 to make them applicable to transactions between a local exchange carrier's ("LEC's") nonregulated activities and a nonregulated affiliate.[3] Prior to this amendment, Section 32.27 reflected that it was only applicable to transactions with the LEC's "regulated activity." In fact, Section 32.27 contained six (6) references to transactions with a LEC's "regulated activity." The Report and Order replaced these six (6) references with phrases such as "services provided between a carrier and its affiliate." While the inapplicability of Section 32.27 to a LEC's nonregulated activities has been debated extensively in a separate non-rulemaking proceeding, SWBT's Application for Review of the Common Carrier Bureau's ("Bureau") order concerning the Citizens Utilities CAM,[4] the NPRM did not provide any notice that the Commission intended to address this particular issue

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[3] NPRM, Appendix B.

[4] Citizens Utilities Company Permanent Cost Allocation Manual for the Separation of Regulated and Nonregulated Costs, AAD 94-6, Memorandum Opinion and Order, 11 FCC Rcd 4676 (1996) review denied, Order on Review; FCC 97-33, released February 6, 1997; SWBT Petition for Reconsideration, AAD 94-6, filed January 26, 1995; SWBT Application for Review, AAD 94-6, filed May 22, 1996.

in this proceeding.[5] As a result, SBC and others were deprived of the opportunity to comment on this change to Section 32.27.

As a further result, because the Commission did not invite comment on this issue, the Commission did not have a record sufficient to permit it to adequately explain the reason for the rule change.

Not only did the Commission fail to explain its reasoning for this rule change in the Report and Order and the NPRM, the NPRM indicated that subjects such as this would be addressed, if at all, "after completion of this proceeding."[6] Previously, in the 1993 Affiliate Transaction NPRM,[7] the Commission had proposed a similar change to Section 32.27. However, the current NPRM only sought comment on those rule changes proposed in 1993 to the extent they were described in the NPRM.[8] With respect to other rule changes proposed in 1993 but not described in the current NPRM, the NPRM states, "We intend to address in a subsequent order in Docket No. 93-251 any matters in that rulemaking that remain unaddressed after completion of

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[5] The issue in this proceeding is not identical to the issue in the Citizens CAM proceeding. Not being a rulemaking, the Citizens CAM proceeding did not consider substantive arguments for or against adoption of a rule change to expand the applicability of Section 32.27.

[6] NPRM, n.118.

[7] Amendment of Parts 32 and 64 of the Commission's Rules to Account for Transactions Between Carriers and Their Nonregulated Affiliates, CC Docket No. 93-251, Notice of Proposed Rulemaking, 8 FCC Rcd 8071 ¶¶107-108 (1993).

[8] NPRM, ¶65 ("We invite comment on whether, in implementing the 1996 Act's provisions regarding subsidization, we should amend the current affiliate transactions rules to incorporate certain of the modifications proposed in the *Affiliate Transactions Notice*. We discuss these modifications below.").

this proceeding."[9] Consequently, the NPRM expressly excluded this issue from the rule changes being considered in this proceeding.

The only implied references to this rule change in the Report and Order are embedded in a ruling on a different issue. The NPRM proposed several changes to the valuation methods for affiliate transactions. As one alternative, the NPRM considered applying the modified valuation methods only in the case of "entities that engage in activities for which the 1996 Act requires the use of a separate or separated subsidiary."[10] However, the NPRM stated as follows:

> We believe that application of our affiliate transactions rules, as we propose to modify them, to transactions between an incumbent local exchange carrier and any of its affiliates engaged in activities that Sections 260, 275 and 276 of the 1996 Act might permit or require the carrier to offer through a separate affiliate would be consistent with these statutory mandates. We therefore seek comment on whether we should apply the affiliate transaction rules, with the proposed modifications, to transactions between an incumbent local exchange carrier and any of its affiliates engaged in activities that Sections 260, 275 and 276 might permit or require the carrier to offer through a separate affiliate.[11]

The issue described in this portion of the NPRM was which affiliates should be governed by the modified valuation methods to be used by the LEC, not whether or not the affiliate transaction rules should apply to certain types of transactions with those affiliates. In the Report and Order, the Commission decided that the LEC must apply the modified rules in its transactions with all affiliates. In describing this change with respect to several types of affiliates, the NPRM includes language such as the following:

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[9] NPRM, n.118.

[10] Id., ¶66.

[11] Id., ¶118 (emphasis added).

> In order to protect against the subsidies prohibited by section 260, we conclude that we must apply our affiliate transactions rules to all transactions between non-BOC incumbent local exchange carriers and their affiliates engaged in telemessaging activities.[12]

The Commission has not explained why it believes the LECs must apply the revised rule to "all transactions" in order to protect against the subsidies described in Sections 260, 271(b), 275 and 276, i.e. subsidy at the expense of the LEC's "telephone exchange service or its exchange access."[13] In particular, in adopting this unexplained rule change, the Commission has not explained why the Part 64 cost allocation rules are not adequate to protect against cross-subsidy in connection with a LEC's performance of nonregulated activities on behalf of these nonregulated affiliates or vice versa. In the separate Citizens CAM proceeding, SWBT and other LECs have explained why the Part 64 cost allocation rules are more than adequate to protect the LEC's regulated ratepayers against cross-subsidy.[14] The Commission did not permit this issue to be adequately addressed in comments in this proceeding, and as a result, the Report and Order does not justify this expansion of the affiliate transaction rules. Also, the Report and Order does not explain why it reached a conclusion contrary to the Joint Cost Proceeding.[15]

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[12] Id., ¶252 (emphasis added).

[13] 47 C.F.R. §260(a)(1).

[14] In denying SWBT's Application for Review, the Commission determined that the Bureau correctly interpreted the affiliate transaction rules as being applicable to a carrier's performance of nonregulated activities on behalf of an affiliate. Order on Review, ¶¶11-13. The Commission explained that, notwithstanding the rule's references to "regulated activity," the determining factor is whether the transaction is recorded in the Part 32 system of accounts. Id. ¶¶5, 7-10. The Commission did not address SWBT's arguments concerning the sufficiency of the Part 64 cost allocation rules to protect against cross-subsidy.

[15] See In the Matter of Separation of costs of regulated telephone service from costs of nonregulated activities. Amendment of Part 31, the Uniform Service of Accounts for Class A

The Commission says that it must apply the rules to "all transactions" in order to protect against the cross-subsidies described in various sections of the 1996 Act. However, consistent with the Joint Cost Order, these provisions of the 1996 Act only prohibit cross-subsidy at the expense of the LEC's regulated activities. For example, Section 275 states that the LEC "shall . . . not subsidize its alarm monitoring services either directly or indirectly from telephone exchange service operations." As SWBT has explained in more detail in the Citizens CAM proceeding,[16] because the Part 64 cost allocation rules remove from regulation all of the costs attributable to a nonregulated activity, such as alarm monitoring, it is not necessary to apply the affiliate transaction rules to further break down the nonregulated costs into the amount of costs (or revenue) attributable to each transaction with each affiliate.

Because this issue has not been adequately addressed in this proceeding, the Commission should issue a further notice on this issue in which the Commission would reconsider its unstated reasons for this change in light of the record on the issue in other proceedings.

II. INCIDENTAL INTERLATA SERVICES SHOULD NOT BE CLASSIFIED AS NONREGULATED SOLELY FOR FEDERAL ACCOUNTING PURPOSES.

The Commission should reconsider its decision to treat incidental interLATA services as nonregulated activities strictly for federal accounting purposes. While the Report and Order

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and Class B Telephone Companies to provide for nonregulated activities and to provide for transactions between telephone companies and their affiliates. CC Docket No. 86-111, 2 FCC Rcd 1298 ¶¶40, 294 (1987) ("Joint Cost Order"), recon., 2 FCC Rcd 6283 ¶¶115-117, 121 (1987) ("Joint Cost Recon Order"), further recon., 3 FCC Rcd 6701 (1988). ("[I]t would not be clear whether the regulated entity should follow its cost allocation manual or the rules for affiliated transactions.")

[16] SWBT Ex Parte Comments, AAD 94-6, filed September 19, 1996, at 2-4, 12.

acknowledges that Parts 36 and 69 will identify interstate costs and attribute the interstate interLATA service costs to the interexchange basket separate from local exchange and exchange access costs, the Commission determines that it must use Part 64 to achieve "greater accuracy" in safeguarding against cross-subsidization.[17]

Such use of Part 64 is inconsistent with its underlying principles. Under Parts 32 and 64, the costs of a Title II common carrier communications service are considered regulated costs, and yet, the Report and Order requires that all incidental interLATA services be treated as nonregulated solely for federal accounting purposes. Thus, even if the incidental interLATA service qualified as a Title II common carrier communications service, the Report and Order requires it to be considered nonregulated for accounting purposes. Obviously, asserting common carrier regulation over such an incidental interLATA service would be inherently inconsistent with the accounting treatment required by the Report and Order. The Commission cannot have it both ways under its current system of regulation in Parts 32, 36, 64, 69, and 61. It must either refrain from regulating incidental interLATA services (even if some of them are Title II common carrier services), which means they would be nonregulated, or it must treat all Title II common carrier communications services consistently as regulated under its accounting rules.

In a conclusory fashion, the Commission determines that its existing regulation of interLATA telecommunications services is inherently imprecise and that it must treat these services as nonregulated under Part 64 in order to accurately safeguard against cross-subsidy.[18]

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[17] Report and Order, ¶76.

[18] Id.

However, the Commission does not explain why its regulations under Parts 36, 69 and 61 will provide inadequate protection, nor why it believes that Part 64 will accomplish a level of accuracy that is sufficiently greater to justify the added regulatory burden of categorizing incidental interLATA service costs as nonregulated. It is not at all clear why the separation of incidental interLATA service costs from those of local exchange and exchange access service, as required under existing Part 36 and Part 69 rules, is not adequate protection.[19] As PacTel noted, the Commission previously concluded that "[c]apping a basket of services . . . assures, along with other existing regulatory controls, that cross-subsidization of services outside the basket by those inside does not occur."[20] Without explanation, the Report and Order reaches the opposite conclusion by questioning the efficacy of these same existing rules.[21]

In any event, if the existing rules for interLATA telecommunications services are imprecise or are otherwise not functioning properly, the Commission should fix any problems with these existing rules, instead of misapplying a regulatory mechanism that is not intended to separate the costs of one regulated service from those of the remaining regulated services.[22] One

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[19] See SBC Comments at 19-22; PacTel Comments at 10-12;

[20] Policies and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, 3 FCC Rcd 3195 ¶279 (1988).

[21] The Report and Order implies that existing Part 36 and Part 69 rules would allow improper cost allocation between these interLATA services and local exchange and exchange access services, but it does not explain how this misallocation would occur or whether the misallocation would be significant.

[22] In fact, by initiating its access reform proceeding, the Commission should be able to adapt its existing regulations to the new competitive local exchange market conditions. The access reform proceeding should remedy the imprecisions in the existing regulations applicable to incidental interLATA services. Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Transport Rate Structure and Pricing; Usage of the Public Switched

consequence of this jerry-rigging is that regulatory treatment of incidental interLATA services that are Title II common carrier services will be inconsistent with that of all other Title II common carrier services.

Even though there are inefficiencies and imprecisions in the existing Part 36 and Part 69 regulations, the Report and Order does not describe them or assess whether their magnitude is sufficient to justify the Report and Order's makeshift application of Part 64.

The Report and Order also fails to consider, as argued by SBC,[23] that each type of incidental interLATA service listed in Section 271(g) is either regulated or nonregulated. If it is nonregulated, such as video programming or an information service, then Part 64 will fully allocate the underlying costs of those nonregulated services that utilize incidental interLATA services. This alone will be adequate protection without categorizing all incidental interLATA services to nonregulated accounts.

For the foregoing reasons, the Commission should reconsider and reverse its decision to classify all incidental interLATA services as nonregulated for federal accounting purposes.

III. THE SCOPE OF THE CHAIN TRANSACTION PRINCIPLE.

The Report and Order states as follows: "Under the principle of 'chain transactions,' our affiliate transaction rules also apply to any transactions between the section 272 affiliate and a nonregulated affiliate of the BOC, such as a services affiliate, that ultimately result in an asset or

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Network by Information Service and Internet Access Providers, CC Docket Nos. 96-262, 94-1, 91-213, 96-263, Notice of Proposed Rulemaking, Third Report and Order and Notice of Inquiry, FCC 96-488, released Dec. 24, 1996.

[23] SBC Comments at 20.

service being provided to the BOC."[24] The Commission should clarify that this statement is not intended to expand the "chain transaction" principle. For example, the "chain transaction" principle, as originally explained in the 1988 NYNEX CAM Order,[25] was not applicable if the prevailing price method applied to the transaction between the LEC and its affiliate. However, the above-quoted sentence of the Report and Order does not recognize this limitation of the "chain transaction" principle. Instead, the Report and Order implies that the affiliate transaction rules apply to any and all transactions between a section 272 affiliate and a nonregulated affiliate that have any linkage to the LEC. The Commission should clarify that the "chain transaction" principle only applies in the circumstances described in the 1988 NYNEX CAM Order.

IV. APPLICATION OF THE EXOGENOUS COST RULE TO REALLOCATION OF INVESTMENT FROM REGULATED TO NONREGULATED ACTIVITIES.

The Commission should reconsider its interpretation of Section 61.45(d)(1)(v) of its rules as requiring an exogenous adjustment whenever costs are reallocated from regulated to nonregulated activities. It is an overbroad interpretation of Section 61.45(d)(1)(v) to construe it to require exogenous changes with every routine reassignment of costs from the regulated to the nonregulated jurisdiction, a result not intended by the price cap rules. As SBC and other LEC commenters explained, Section 61.45(d)(1)(v) is only intended to apply to the reallocation of

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[24] NPRM, ¶183 (emphasis added).

[25] NYNEX Telephone Companies' Permanent Cost Allocation Manual for the Separation of Regulated and Nonregulated Costs, AAD 7-1678, 3 FCC Rcd 5978 ¶¶21-25 (1988).

network investment required under Section 64.901(b)(4) when the LEC underforecasts the nonregulated usage of that investment.[26] The Commission erred in rejecting the LECs' explanation of Section 61.45(d)(1)(v).

While other subsections of Section 61.45(d) permit the Commission to order an exogenous cost change under appropriate circumstances, it is SBC's position that specific subsection 61.45(d)(1)(v) is not triggered whenever "costs are reallocated from regulated to nonregulated activities"[27] because that subsection, by its expressed terms, applies only to reallocation of investment pursuant to Section 64.901. Section 64.901 deals with a number of provisions of the cost allocation rules aside from investment reallocation. It is highly unlikely that the Commission intended Section 61.45(d)(1)(v) to refer to all of Section 64.901. And, if one reviews Section 64.901, a logical tie is seen between Section 61.45(d)(1)(v) and Section 64.901(b)(4). Section 64.901(b)(4) applies only to the "allocation of central office equipment and outside plant investment costs between regulated and nonregulated activities."[28] Subsection (b)(4) is the only subsection of Section 64.901 that relates to the reallocation of investment costs from regulated to nonregulated activities. Thus, subsection (b)(4) of Section 64.901 is the only subsection logically applicable to Section 61.45(d)(1)(v), since it deals with the allocation of investment as referenced by Section 61.45(d)(1)(v).

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[26] SBC Comments at 49-50; NYNEX Comments at 31-34; PacTel Comments at 35-40.

[27] Report and Order, ¶265.

[28] The principles of the network investment allocator in Section 64.901(b)(4) are explained in the Joint Cost Recon Order, 2 FCC Rcd at 6285-91 ¶¶17-70.

The logic of this connection between Section 61.45(d)(1)(v) and Section 64.901(b)(4) is explained in more detail in the LECs' comments[29] and is reinforced by the portion of the Joint Cost Recon Order that adopted the network investment forecast and reallocation principles embodied in Section 64.901(b)(4). Section 61.45(d)(1)(v), like Section 64.901(b)(4), was not intended to address the routine reassignment of assets; rather, it was specifically structured to "deter manipulative underforecasting of nonregulated usage [of network assets] and to mitigate the impact on ratepayers of unintended or unavoidable underforcasts."[30] This protects ratepayers from "underwriting the costs of unused capacity which is eventually used to meet unforeseen nonregulated demand."[31] This was and is the specific targeted function of forecasting the usage of common network investment as required in the ARMIS 495-A and 495-B reports filed with the Commission. This was the network investment allocation principle which was in place, and which must have been contemplated, when the Commission crafted the exogenous cost principle in Section 61.45(d)(1)(v).

The narrow interpretation of Section 61.45(d)(1)(v) is more logical than the broad interpretation adopted in the Report and Order. There are currently, and may in the future be, many instances in which the LEC will change or move assets or lines of business from the regulated to the nonregulated jurisdiction. Also, a LEC may enter lines of business that may make new uses of communications networks. If a LEC must make an exogenous cost change

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[29] See, e.g., NYNEX Comments at 31-32; PacTel Comments at 35-40.

[30] Joint Cost Recon Order, at 6290-91, ¶64.

[31] Id.

each time assets are moved from regulated to nonregulated accounts, the resulting reduction in revenues will be significant and substantial. It is counter-intuitive for regulated prices to decrease each time a LEC enters another nonregulated product or service market.

Such a result is inconsistent with the intent and principles of price cap regulation. Routine reassignments of regulated costs to the nonregulated jurisdiction should not require exogenous decreases to regulated prices, especially (but not limited to) when the investment being reassigned is new investment placed after the original price cap was set based on costs in 1990-91.

The Report and Order's interpretation of Section 61.45(d)(1)(v) is inconsistent with the expressed purpose of price cap regulation of severing the linkage between costs and prices. SBC and other commenters pointed out this conflict with price cap regulation, but the Report and Order fails to address it.[32] The Report and Order also fails to respond to NYNEX's references to previous orders of the Common Carrier Bureau clearly indicating the narrow scope of Section 61.45(d)(1)(v), including a ruling in which the Bureau rejected arguments by MCI for a broad application of this exogenous cost rule.[33] The Annual 1991 Access Tariff Order states that, in response to MCI's arguments, "LECs assert that the only reallocations of costs from regulated to non-regulated activities requiring exogenous treatment are those completed pursuant to Section 64.901 of the Commission's Rules, . . . that the exogenous adjustments suggested by MCI fall

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[32] Bell Atlantic Comments at 10-12; PacTel Comments at 38; SBC Comments at 49; SBC Reply Comments at 26-27 & n. 69; USTA Comments at 8-9.

[33] NYNEX Comments at 32 (citing Annual 1991 Access Tariff Filings, 6 FCC Rcd 3792, ¶¶ 49-54 & n.23 (1991)).

outside the ambit of Section 64.901"[34] and that "the existing ARMIS reporting requirements [i.e., the 495-A and 495-B reports] are adequate to track the reallocations involved."[35] The Annual 1991 Access Tariff Order concluded that the "LEC replies appear to address this question adequately."[36]

The Commission's re-interpretation of Section 61.45(d)(1)(v) also makes little sense from a practical standpoint. The routine allocation of costs is processed and calculated on a monthly basis in the LEC's mechanized cost allocation system designed to follow the LEC's Cost Allocation Manual ("CAM"). These calculations are driven by hundreds of cost drivers (i.e., allocators) that fluctuate on a monthly basis. The result is a monthly fluctuation in the percentage of regulated costs in each allocated cost category. Thus, there is a recurring reallocation of costs between the regulated and nonregulated jurisdictions. To suggest that LECs must give exogenous treatment to this monthly ebb and flow of data is unworkable. Not only would the complexity of this analysis be virtually insurmountable, it would create a constant ratcheting down of access rates based on irregular monthly fluctuations in cost allocations.

The Commission should reconsider its incorrect interpretation of Section 61.45(d)(1)(v) in light of the original purpose of Section 61.45(d)(1)(v) and the price cap rules as well as arguments presented by commenters that were not addressed in the Report and Order.

V. LECS MUST HAVE AT LEAST SIX MONTHS TO IMPLEMENT ACCOUNTING RULE CHANGES.

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[34] Annual 1991 Access Tariff Order, 6 FCC Rcd 3792, 3798 ¶51.

[35] Id. at 3799 ¶53.

[36] Id. at 3799 ¶54.

Paragraph 286 of the Report and Order states as follows:

> [T]he requirements and regulations established in this decision shall become effective upon approval by OMB of the new information collection requirements adopted herein but no sooner than thirty days after publication in the Federal Register.

As applied to the accounting rule changes adopted in the Report and Order, Paragraph 286 is contrary to Section 220(g) of the Communications Act of 1934, as amended, which states as follows:

> Notice of alterations by the Commission in the required manner or form of keeping accounts shall be given to such persons by the Commission at least six months before the same are to take effect.

Paragraph 286 is also contrary to the Commission's prior decisions applying Section 220(g) to other accounting rule changes, including prior amendments to Part 32.[37]

In view of the lead-time required by Section 220(g), the Commission should revise the text of the Report and Order in conformity with Section 220(g), or otherwise provide notice, to reflect that LECs have up to six months to implement the Report and Order's Part 32 amendments.

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[37] See, e.g., The Accounting and Ratemaking Treatment for the Allowance for Funds Used During Construction (AFUDC), CC Docket No. 93-50, 10 FCC Rcd 2211 ¶25 (1995); Amendment of Part 32 of the Commission's Rules to Implement Statement of Financial Accounting Standards No. 96 Accounting for Income Taxes, CC Docket No. 89-360, 9 FCC Rcd 727, 729 ¶15 (1994); Procedures for Implementing the Detariffing of Customer Premises Equipment and Enhanced Services (Second Computer Inquiry), CC Docket No. 81-893, Fifth Report and Order, FCC 84-547, released November 20, 1984, ¶31; Amendment of Part 31, 99 F.C.C. 2d 58 ¶¶47-48, 51 (1984); Amendment of the Uniform System of Accounts to increase the dollar limit for expensing minor items, CC Docket No. 81-273, 87 F.C.C. 2d 1137 ¶16 (1981). See also Revision to amend Part 31 as it relates to the treatment of certain individual items of furniture and equipment costing $500 or less, CC Docket No. 87-135, 4 FCC Rcd 8229 ¶¶12, 15 (1989).

VI. THE SECTION 274(f) REPORTING REQUIREMENT.

Section 274(f) requires an electronic publishing "separated affiliate" to file with the Commission "annual reports in a form substantially equivalent to the Form 10-K required by regulations of the Securities and Exchange Commission [SEC]."[38] The NPRM expressed an intention of minimizing the burden on filing companies.[39] To accomplish this objective for those "separated entities" that are required to file a Form 10-K with the SEC, the Commission adopted the NPRM's proposal to accept the same Form 10-K filed with the SEC.[40]

For those "separated entities" not subject to the SEC's Form 10-K requirements, the NPRM had requested comments as to what Section 274(f) meant by "substantially equivalent to the Form 10-K."[41] This request suggested the Commission was considering some simplification of the Section 274(f) reporting requirement based upon a reasonable interpretation of "substantially equivalent" in this context. Instead, the Report and Order requires that such "separated affiliates" file a report containing exactly "the same information as is required in the SEC's Form 10-K."[42]

"Substantially equivalent" does not mean "identical." The Commission should reconsider the Section 274(f) reporting requirement as applied to "separated affiliates" not

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[38] 47 U.S.C. §274(f). The Conference Report explains this provision as requiring an annual report "similar to Form 10-K." Conference Report 104-458 on S.652, 104th Cong., 2d Sess., February 1, 1996 at 156.

[39] NPRM, ¶108.

[40] Report and Order, ¶230.

[41] NPRM, ¶108.

[42] Report and Order, ¶230.

subject to the SEC reporting requirement and adopt a simplified report that contains a substantial part, but not all, of the information in the SEC Form 10-K.

The Commission should require responses to the items of the Form 10-K only to the extent truly necessary "to ensure compliance with the provisions of section 274."[43] For example, Item 8 of Form 10-K requires audited financial statements prepared in the manner set forth in the detailed guidelines in the SEC's Regulation S-X.[44] The preparation of such financial statements and the associated certified public accountant's report would cause such "separated affiliates" to incur a large expense which is not necessary for the Commission to determine whether the "separated affiliate" has complied with Section 274.[45] Instead, the Commission should accept unaudited financial statements that contain substantially the same financial information.[46] Even the SEC accepts unaudited financial statements for interim periods.[47] Obviously, compared to the Commission's limited role regarding financial disclosure, the SEC has a stronger need for detailed financial information from public companies to assure full disclosure for the protection of investors. The Commission should reduce the burden of this reporting requirement by accepting the alternative of unaudited financial statements.

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[43] Id.

[44] 17 C.F.R. part 210.

[45] This discussion assumes that the "separated affiliate" is not considered a significant subsidiary under SEC Rules, and thus, is not required to submit separate financial statements.

[46] See SBC Comments at 48-49.

[47] 17 C.F.R. §210.10-01.

The Commission could allow other unnecessary data to be omitted from the report without compromising its ability to assure compliance with the requirements of Section 274. A list of several recommendations is attached as Exhibit "A" to this Petition.[48] The Commission should consider these recommendations in light of the pro-competitive, deregulatory objectives of the 1996 and not require disclosure beyond what is reasonably necessary to enforce compliance with Section 274.

[48] SBC's original recommendations were more general in nature. See SBC Comments at 48-49.

VII. CONCLUSION.

For the foregoing reasons, the Commission should reconsider the Report and Order and grant the relief requested herein.

Respectfully Submitted,

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